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In the Supreme Court of the United States

OCTOBER TERM, 1960.

No. _____.

HOMER H. and INA MAE MARSHMAN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI

To the United States Court of Appeals for the Sixth Circuit.

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To the United States Court of Appeals for the Sixth Circuit.

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit entered in the above case on May 31, 1960.

OPINIONS BELOW.

The opinions of the Tax Court of the United States (R. 93a, 98a) are reported at 30 T. C. 1244; 31 T. C. 269. The opinion of the Court of Appeals for the Sixth Circuit (App. *infra*) is reported at 60-2 U. S. T. C. Para. 984.

JURISDICTION.

The judgment of the Court of Appeals for the Sixth Circuit was made and entered on May 31, 1960, and copies thereof are appended to this petition at pp. 20-33. The jurisdiction of this Court is invoked under 28 U. S. C. 1254(1).

QUESTIONS PRESENTED.

Petitioners brought an action in the Tax Court of the United States challenging a deficiency in Federal Income Taxes asser d by the Respondent. The Tax Court held that the cost basis of shares of stock obtained by a wife in a divorce settlement may be determined by the value ascribed to such shares by the parties to the divorce and it found that the parties in this case had in fact arrived at such a valuation.

The Court of Appeals for the Sixth Circuit reversed the Tax Court, holding in effect that no cost basis can be ascribed to property transferred to a wife as part of a divorce settlement because it is impossible to determine the value of the assets exchanged therefor. (e.g. the marital rights surrendered by the wife.) The Court held further that the findings of fact of the Tax Court were incorrect and substituted its own findings to the effect that the parties had not arrived at an agreed value for the property transferred. The questions presented are:

1. When an asset is transferred from a husband to a wife as a part of the settlement of his marital obligations to her and in accordance with a decree of court granting her an absolute divorce from him, is the cost basis of this asset in the hands of the wife properly measured by the value ascribed to the asset by the parties or, failing that, by the fair market value of the asset at the time of transfer?

2. When the Tax Court has made a finding of fact which is reasonable and which has substantial basis in the evidence presented at the hearing on the matter, is it proper for a reviewing court to set aside such finding of fact and to substitute one of its own which in the opinion of the reviewing court is more reasonable and can be supported by evidence in the record?

STATUTES, FEDERAL RULES, AND REGULATIONS INVOLVED.

The pertinent portions of Internal Revenue Code of 1939, Sections 22, 111 and 112 and Treasury Regulations 111, Section 29.111-1 are set forth in the Appendix *infra* at pp. 34-35.

STATEMENT.

1. The chain of events which culminated in the questions now being presented to this Court began with the remarriage of Ina Mae Marshman, one of Petitioners, to Gordon Stouffer on March 7, 1937. (Stip. Para. 6, R. 5a.)

2. In the period between marriages, Ina Mae had experienced some rather severe financial problems. As a result of this, before consenting to the remarriage, and as a condition precedent thereto, Ina Mae insisted that Gordon Stouffer transfer something of value to her name. (Stip. Para. 6, R. 38a.)

3. Pursuant to the condition imposed by Ina Mae, on March 6, 1937, Gordon Stouffer assigned by written instrument (Pet. Ex. 21, R. 28a) 2,000 shares of Class B or voting stock of The Stouffer Corporation to Ina Mae, and Ina Mae concurrently gave to Gordon Stouffer a written option (Joint Ex. 7-G, R. 12a) to repurchase these shares, together with all stock dividends thereon for $40,000.00. (Stip. Para. 6, R. 38a-39a.)

4. On March 6, 1937, the shares of Stouffer Class B assigned to Ina Mae, as aforesaid, had a fair market value of $20.00 per share, and a basis in the hands of Gordon Stouffer of $5.00 per share. (Stip. Para. 7, R. 5a.)

5. As a result of changes in the capital structure of The Stouffer Corporation, the original 2,000 shares of Class B, subject to the option, were exchanged for 10,000 shares

of Class B in 1940 (Stip. Para. 16, R. 8a); these were exchanged for 10,000 shares simply denominated common stock, $5.00 par, in 1945 (Stip. Para. 18, R. 9a) and these were exchanged for 20,000 shares common stock, $2.50 par, in 1949. (Stip. Para. 21, R. 10a.)

6. Throughout the period 1937 to 1951, Ina Mae acquired other stock of The Stouffer Corporation, but, acting with the advice and concurrence of her then husband, Gordon Stouffer, she scrupulously maintained the shares of stock, which were subject to the option, separate and apart from any other shares. (Stip. Para. 14, 16, 19, 21, 27, R. 38a-43a.)

7. As a result of the various exchanges heretofore recited, in May, 1951, there were 20,000 shares of common stock of The Stouffer Corporation registered in the name of Ina Mae Stouffer, but subject to an option held by Gordon Stouffer to purchase them for $40,000.00. (Para. 3, 4, 5, 6 above.)

8. On May 10, 1957, Ina Mae and Gordon Stouffer entered into a Separation Agreement (Joint Ex. 12-L, R. 13a) which, among other things, provided that upon the award of a divorce to either party, Gordon would release any interest which he had in the Stouffer stock standing in the name of Ina Mae. This provision was designed solely to release Gordon's option from the 20,000 shares previously described. (R. 44a-45a.)

On June 27, 1951, Ina Mae was granted a divorce from Gordon Stouffer and the aforesaid Separation Agreement was incorporated into and made a part of the divorce decree. (Stip. Para. 26, R. 12a.)

10. In negotiating the Separation Agreement, the parties treated the option held by Gordon Stouffer as being an asset of a value of $360,000.00. (20,000 shares @ $20.00

less the option price of $40,000.00) and they treated the release of these option rights as equivalent to the transfer of a $360,000.00 value. (R. 45a-50a, Pet. Ex. 17, R. 23a, 67a-68a.)

11. In 1952, Ina Mae sold 100 shares out of those which had formerly been subject to the option, and in 1953, she sold 4,750 shares of such stock. In each instance, Petitioners reported these shares as having a basis of $20.00 each (R. 50a-51a), that having been the market value of the stock on the date the option was released and that being the value used by both parties in the course of their negotiations.

12. The Respondent asserted that the proper basis for this stock was 50¢ per share, the commuted basis of the shares in the hands of Gordon Stouffer on March 7, 1937, and he assessed a deficiency in Income Tax accordingly. (Op. Tax Ct. R. 95a.)

13. At the same time Respondent assessed a deficiency against the Estate of Gordon A. Stouffer, deceased, on the theory that Gordon Stouffer had realized a gain in connection with the transfer of these same shares, which gain was measured by the difference between their cost basis in his hands and their agreed or fair market value at the time of the divorce decree, less $40,000.00 which was the option price. (Op. Tax Ct. R. 98a, 108a.)

14. Respondent admitted that the position he took with respect to the Estate of Gordon A. Stouffer was inconsistent with the position he took regarding the Petitioners and he recognized that if he prevailed in one position, he could not prevail in the other. (Op. Tax Ct., R. 95a.)

15. Both taxpayers filed their petitions with the Tax Court and the cases were heard at the same time and on a

single record, although they were not consolidated. (Docket Entry Tax Ct., R. 2a.)

16. The Tax Court ruled in accordance with the decisions of *Commissioner v. Mesta* (CCA 3rd 1940) 123 F. (2d) 986; *Commissioner v. Halliwell* (CCA 2nd 1942) 131 F. (2d) 624; *Commissioner v. Patino* (CCA 4th 1950) 186 F. (2d) 962; and *Aleda N. Hall* 9 T. C. 53 (1947); that the husband in a divorce settlement is chargeable with gain on assets transferred to the wife to the extent that the agreed value or market value of the property transferred exceeds his cost basis and, as a corollary thereto, that the wife's basis in the property is measured by the agreed or fair market value at the time of transfer. (Op. Tax Ct., R. 93a, 98a.)

17. The Tax Court found as a fact that Gordon Stouffer and Ina Mae had negotiated on the basis that the option released by Gordon had a value of $360,000.00 (Op. Tax Ct. R. 104a-105a), (20,000 shares at $20.00 less the option price of $40,000.00) and it determined the respective tax liabilities on that basis (Decision Tax Ct. 109a-110a). The court also found that this was the actual market value although it was not required to do so in view of the agreement of the parties. (Op. Tax Ct., R. 106a-107a.)

18. The Estate of Gordon A. Stouffer took its appeal from the decision of the Tax Court to the Court of Appeals for the Sixth Circuit and, solely to protect his position, Respondent filed an appeal from the decision of the Tax Court with respect to Petitioners Homer H. and Ina Mae Marshman. (Docket Entries Tax Ct., R. 2a, 4a.)

19. The Court of Appeals for the Sixth Circuit refused to follow the reasoning of the Third Circuit in the *Mesta* case; the Second Circuit in the *Halliwell* case or the Fourth Circuit in the *Patino* case and it held to the contrary that the husband could not be chargeable with a

gain on the property transferred because the bundle of marital rights which was discharged in exchange therefor was not susceptible to actuarial appraisal. (Op. 6th Cir. pp. 7-9, App. *infra*.) Accordingly, the Court reversed the decision of the Tax Court with respect to the Estate of Gordon A. Stouffer and also with respect to these Petitioners, Homer H. and Ina Mae Marshman. (Op. 6th Cir. pp. 11, App. *infra*.)

20. As an additional grounds for reversal the opinion in the Sixth Circuit challenged the findings of the Tax Court with respect to the weight of the evidence and ordered the case involving the Petitioners remanded to the Tax Court for redetermination in accordance with the reviewing court's appraisal of the record. (Op. 6th Cir. pp. 9-10, App. *infra*.)

21. Respondent has filed or is filing a Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit in respect to the companion cases involving the Estate of Gordon A. Stouffer which were designated as Docket Nos. 13945 and 13946 in that court.

REASONS FOR GRANTING THE WRIT.

The decision below should be reviewed because it creates a conflict with the decisions of other courts of appeals on the same question and also because it represents a distinct departure from the accepted principles of judicial review as defined by prior decision of this court.

I. Conflict.

There is no question that the decision which is sought to be reviewed creates a conflict with decisions entered by other courts of appeals. The opinion itself refers to *Commissioner v. Mesta* (CCA 3rd 1940) 123 F. (2d) 986, which reversed the Board of Tax Appeals and states at p. 7 thereof (App. *infra*, 27).

"We agree with the reasoning of the Board of Tax Appeals in its opinion in the *Mesta* case that the wife's rights to maintenance and support and to share in the husband's estate in the event of his death are dependent upon so many uncertain factors and are of such a nature as to make it impossible to ascribe to it a 'fair market value' as required by the statute. A review of these factors is given by the Board in 42 B. T. A. at p. 940, to which reference is made. We do not think that this problem is correctly solved by giving to those rights the value of the property which is given in exchange."

Not only does this decision create a conflict with the *Mesta* case to which reference is made but it also creates a conflict with *Commissioner v. Halliwell* (CCA 2nd 1942) 131 F. (2d) 642; and *Commissioner v. Patino* (CCA 4th 1950) 186 F. (2d) 962 both of which relied specifically on the principles announced in the *Mesta* case and both of which have long been considered the settled law in their respective jurisdictions.

The opinion in the Sixth Circuit attempts to soften the conflict by reference to the *Mesta* case as a "closely analogous question" and by attempting to draw some factual distinctions. The decision of the Sixth Circuit is nevertheless in direct and complete conflict with the *Mesta* case because it directs the Tax Court to enter judgment for taxpayer in the Stouffer case and against taxpayers in the Marshman case which precludes any consideration of the so-called factual distinctions.

Mesta and cases which followed it established very definite principles of law, viz.:

(a) The transfer of property by a husband to his estranged wife in connection with a divorce proceeding is a taxable event which may result in the realization of a taxable gain by the husband and which will

establish the basis of the assets in the hands of the wife.

(b) Since the value of the marital rights surrendered by the wife and hence received by the husband is frequently difficult to establish by normal economic tests, the best measure is the value ascribed to them by the parties which may be established by their agreement or by the market value of the assets given in exchange.

(c) The husband, having received the discharge of his marital obligations in exchange for the assets transferred, is chargeable with the difference between his cost basis and the value of the discharged obligations measured as in (b) above, as a capital gain.

(d) The wife having surrendered her marital rights in exchange for the assets transferred, is entitled to a cost basis equal to the rights surrendered, also measured as in (b) above.

As we analyze the decision below, it does not challenge the underlying philosophy of the *Mesta* case which is really irrefutable, but it completely destroys the effectiveness of the established principles by refusing to apply the measuring device adopted in *Mesta* and related cases. If the decision below is not reviewed by this Court, it will stand for the proposition that a situation which would ordinarily give rise to a capital gain within the meaning of §§ 22(f); 111(a) and (b) and 112(a) of the Internal Revenue Code of 1939 or the comparable sections of the present code, will not be considered a taxable event unless the property transferred lends itself to ready and precise valuation. We submit that this raises not only the direct conflict as indicated but a much broader philosophical conflict which also should be resolved by this Court.

The Court in *Commissioner v. Mesta* (CCA 3rd 1941) 123 F. (2d) 986, reviewed those portions of the Revenue Act of 1934 which were pertinent to the problem (§ 22(a), 22(e), 111(a) and (b), 112 which are substantially the same as the statutes here involved) and concluded:

> "We think there can be no doubt that Congress intended a measurement of values under the circumstances indicated by the statutes quoted, notwithstanding difficulties in determining those values."

Accepting the logic of this conclusion as we feel logic demands, the approach to valuation adopted in *Mesta*, *Halliwell* and *Patino* is inevitable.

The terms "market value," "actual value," "fair value" and the like have come to be used pretty much interchangeably in the law, 16 *Words and Phrases* (Perm. Ed.) 169, and while many efforts have been made to define the terms, none of the definitions vary in any important degree from the following found in *French Dry Cleaning Company v. Commissioner* (CCA 5th 1934), 72 F. (2d) 167:

> "* * * the price at which one willing to sell would sell and a person willing to buy would buy, both being familiar with all the facts and the seller not being forced to sell or the buyer forced to buy."

This being the definition, what more natural place to look than to an actual price set by actual parties dealing at arm's length. In the *Mesta* case and the *Halliwell* case the parties did not set the value in dollars but they did set a value in terms of other commodities which themselves had a readily ascertainable market value, while in the *Patino* case and in the instant case, the parties actually arrived at a dollar valuation. So long as there is nothing to indicate that this agreed value was arrived at through collusion or in some spirit of tax evasion, it represents a good, indeed one of the best, tests of market value which could possibly

be applied. If should be noted parenthetically that in Ohio as in most states the court which incorporates the agreement in its decree is required to find that its terms are fair, just and reasonable. (See, Joint Ex. 13 M, R. 22a.)

In finding fault with the *Mesta* approach, the opinion below seems to lose sight of the fact that, except in rare instances, the science of valuation is at best an educated guess. Professor Wigmore recognized this fact very well when he wrote in his work on *Evidence* (3rd ed.) § 719.

> "But not always is there a market value for an article. In such a case the value is the probable exchangeable rate so far as one can estimate it from the various attendant circumstances and conditions which would affect the disposal of the article * * *."

This fact has also been recognized in respect to the very sections of the Internal Revenue Code with which we are concerned. It is said in *Helvering v. Kendrick Coal & Dock Co.* (CCA 8th 1954) 72 F. (2d) 330:

> "To ascertain the fair market value of property, as the Treasury Regulations above quoted import, it is not necessary that the property actually shall have been sold in a market. Where personal property is sold in a definite and established market, or changes hands for money so regularly that a market price for it is created or maintained, it is obvious that it must have a fair market value. When the question arises as to its fair market value in litigation, the question merely is as to the price it commanded in the market at the particular time. Where, however, there is no such market, but the property has an intrinsic value, then the evidence must show what price that intrinsic value would command on a market where willing buyer and willing seller met."

To the same effect, acknowledging that "fair market value" in most cases is a matter of estimates and judgment

are *Commissioner v. Swenson* (CCA 5th 1932) 56 F. (2d) 544, *Wright, et al. v. Commissioner* (CCA 4th 1931) 50 F. (2d) 727 and a great many of the cases cited in the annotation at 103 *A. L. R.* 958.

In the instant case we are seeking to evaluate the bundle of marital rights which Ina Mae Marshman, then Ina Mae Stouffer, cancelled in exchange for the surrender of his option by Gordon Stouffer. Granted this is not one of those assets which is frequently exchanged in the market and which has a readily ascertainable value but this is not to say that it did not have an actual value or that this value could not be determined by complete and careful analysis. It is certainly not good common sense to conclude that an asset has no market value simply because by nature it has an appeal only among a limited group or within a limited area.

It would be less than wisdom, however, for a court to spend the time and effort necessary to evaluate all phases of a wife's marital rights in a particular jurisdiction when it has readily at hand the very figure it seeks. Certainly no one is better qualified to appraise the various duties and obligations which go to make up a particular bundle of marital rights than the very parties who are involved. When these parties, each aided by competent, experienced counsel and after extended negotiations, arrive at a valuation of the rights transferred, it would be highly presumptuous, not to mention foolhardy, of any court to challenge the efficacy of such valuation.

Since the *Mesta* case was decided, the courts have universally recognized this common sense principle and it is submitted that this Court should add its approval to avoid any further conflicts as represented by the opinion below.

The fact that there are a great many considerations weighed in the balance in any divorce negotiation is a factor in favor of the *Mesta* rule, not against it as the opinion below seems to suggest. In a case of this type we are trying to find out the value of what the husband got for the capital asset he transferred and the value of what the wife gave up for the capital asset she received. It is of no concern what elements went to make up the value so long as we can be certain that the value arrived at covers all the elements involved and, as we stated before, the parties themselves, aided by their attorneys and alerted through extended negotiations, are eminently the best qualified to judge that fact.

The opinion below is also critical of the *Mesta* case because it draws an analogy from *Helvering v. Horst* 311 U. S. 112 (1940). As far as we know, *Helvering v. Horst* is still good law and the principle expressed therein by Justice Stone and quoted in the *Mesta* opinion is still a good principle. Granted the two cases are not the same factually but Judge Biggs in the *Mesta* opinion made no such claim for his quote from *Helvering v. Horst*. He merely suggested that "it supplies an illuminating analogy" and in this he was certainly correct.

The conflict created by the opinion of the Sixth Circuit in the instant case not only goes deep into legal principle but it has an extremely broad practical application. Whether we approve or disapprove, we must recognize the fact that an ever increasing percentage of the time and efforts of lawyers and trial courts is being devoted to problems of divorce and domestic relations. Not in every marital dispute but in a great many of them, the question of transferring capital assets will arise and the taxable consequence of such an event will become an important consideration.

From 1941 until May 31, 1960, every informed lawyer and court relied on the *Mesta* case as being determinative of this question and they acted accordingly. The decision below completely upsets these accepted principles and unless this Court grants the Writ of Certiorari as requested herein and resolves the question, no court and no lawyer can henceforth act in a domestic relations situation with any assurance as to the Federal Income Tax consequences.

II. Improper Appellate Procedure.

In applying the rule of the *Mesta*, *Halliwell* and *Patino* cases, it was of course necessary for the Tax Court to find, as a matter of fact, what value the parties themselves had ascribed to the marital rights being relinquished. As we have seen, this might be accomplished by a direct monetary appraisal as in *Patino*, or by an exchange for other assets which themselves had a readily ascertainable money value as in *Mesta*.

It should be kept in mind that the instant case involves the cancellation of a stock option rather than the actual transfer of stock as in the other cases, although this appears to be a distinction without a difference and no one has suggested that any different treatment should be accorded because of it.

As was pointed out previously, the instant case was heard before the Tax Court in conjunction with the case of Estate of Gordon A. Stouffer and the opinion of the Tax Court which was dispositive of both cases was actually entered in the Stouffer case. In that opinion the Tax Court made the following findings:

> "* * * But the most significant fact is that the great weight of evidence establishes that there was no dispute between the parties as to the validity and enforcibility of the option contract as covering the

20,000 shares in 1951. It is admitted that Gordon was asserting that it covered the 20,000 shares and the weight of the evidence was that Ina Mae agreed that it covered the 20,000 shares." (R. 104a.)

"It is quite evident from all the evidence that during the prolonged negotiations leading to the divorce decree in 1951 the attorneys for both Ina Mae and Gordon treated the option held by Gordon as an asset with a value of $360,000. In a schedule of assets submitted by Gordon's attorneys to Ina Mae's attorneys the option was shown as having a value of $360,000. (Stock of $400,000 less $40,000 option price.) Ina Mae accepted this value as a basis for entering into the separation agreement. She undeniably had valuable marital and other property rights as the wife of Gordon and she was evidently convinced that in obtaining the release of the option, with its agreed upon value of $360,000, she was getting a fair equivalent of a portion of her marital and other property rights. She accepted this release in exchange for such rights. This was deemed fair by counsel for both sides." (R. 105a.)

"Even if we approach the problem by an attempt to determine the fair market value of the stock on the date of the settlement agreement, as was done in the *Mesta* case, the result is the same * * *." (R. 106a.)

The opinion goes on at some length in support of this last conclusion to point out that the market value of the stock was $400,000 less the option price of $40,000, making the transfer $360,000.

The rule is well established that so long as there was substantial evidence upon which the above quoted findings of the Tax Court could be based, the Court of Appeals was bound to accept these findings and was not justified in substituting its judgment for that of the Tax Court. *Elmhurst Cemetery Company of Joliet v. Commissioner*, 300

U. S. 37, (1937); *Helvering v. Rankin*, 295 U. S. 123, (1935); *General Utilities & Operating Co. v. Helvering*, 296 U. S. 200, (1935); *Dobson v. Commissioner*, 320 U. S. 489, (1944).

It is not appropriate here to argue the facts as presented to the Tax Court but some detailing of these facts will be necessary to demonstrate the substantial body of evidence upon which the findings of the Tax Court were based. Keeping in mind the findings which were challenged (i.e. that Ina Mae and Gordon considered the option as valid and that Ina Mae and Gordon treated the release of the option as being the equivalent of the transfer of a $360,000 asset) we will summarize the supporting evidence as briefly as possible.

(a) The option itself (Exhibit 7-G, R. 2a) provided that all cash dividends would go to the seller but that any stock dividends would fall under the option price. This very language reflects the intent of the parties that the option would necessarily cover all proceeds of stock splits and exchanges.

(b) The attorney who drew the option explained to Ina Mae and Gordon that it covered not only the original stock but all shares into which it was split or exchanged. (R. 39a-40a.)

(c) On two occasions, Gordon and Ina Mae added language to the option indicating that stock dividends in Class A or non-voting stock were not to be included under the option. (Stip. Par. 8, R. 6a, Stip. Par. 10, R. 7a, Joint Ex. 7-G, R. 13a.) The conversation at these times was to the effect that the dividends in non-voting stock were not to be included because they were the equivalent of cash dividends, but that other stock

dividends and stock splits were to be included since they represented a proprietary interest in the corporation. (R. 40a-41a.)

(d) Ina Mae and Gordon always referred to the "option stock" and always kept it physically separated from other shares which were in the name of Ina Mae. (R. 40a-43a.)

(e) In 1946 or 1947 when Ina Mae consulted Mark A. Loofburrow concerning her estate, he advised her that the option was good and covered all shares into which the original 2,000 had been split or exchanged. This is the same Mark A. Loofburrow who represented Gordon in the divorce negotiations and who became Executor of Gordon's estate, and hence taxpayer in the companion case. (R. 44a.)

(f) In the course of the negotiations which culminated in a divorce, Gordon and his counsel consistently asserted the position that the option was good and enforcible against 20,000 shares of stock. (R. 45a-48a.)

(g) Counsel for Gordon submitted documents in which the option was treated as an asset with a value of $360,000.00. (Pet. Ex. 17 and 18. R. 23a.)

(h) Ina Mae testified that no one ever suggested to her that there was any question about the validity of the option; that she always treated it as being valid and representing an asset worth $360,000.00. (R. 49a.)

(i) Counsel, who negotiated the final terms and represented Ina Mae when she entered into the Separation Agreement in question, testified that both

parties and counsel concurred in the validity of the option and the value of $360,000.00. (R. 66a-69a.)

We recognize that there can be no positive, unvarying statement of what is meant by "substantial evidence" but it would certainly seem that the above was not only substantial but was overwhelming as the Tax Court in fact concluded. The only evidence which could possibly be construed as being contrary was the testimony of Charles F. Carr, who had represented Ina Mae in preliminary negotiations but had ceased to be her attorney several weeks before an agreement was reached. (Pet. Ex. 23, R. 30a, R. 66a.) Furthermore his testimony was really not contradictory of the findings of the Tax Court even if given full weight. He admitted that he raised the question of the option only as a preliminary matter and did not pursue it (R. 88a-89a, 90a); his time record shows that he did no research concerning the validity or value of the option (Pet. Ex. 23, R. 30a); his recollection of the basis for his challenge is so obviously without merit that it couldn't have been seriously advanced (R. 88a), and he couldn't recall that he ever questioned the option with Ina Mae. (R. 88a.) She, on the contrary, recalled positively that he never had. (R. 49a.)

When the Court of Appeals, referring only to the testimony of this one witness (Op. 6th Cir. pp. 9-10, App. *Infra*) and, disregarding all of the other evidence, substituted its judgment on the facts for that of the Tax Court, it demonstrated quite clearly the wisdom of the rule expressed in the *Rankin*, *Dobson*, *Elmhurst* and *General Utilities* cases that findings of fact should not be inquired into on appeal so long as there is substantial evidence to support them.

The Tax Court of the United States was organized as a trier of facts to relieve our regular court system of this burden with respect to the growing mass of tax litigation. If the appellate courts were free to retry all factual questions whenever they felt so inclined, the function of the Tax Court obviously would be thwarted and it really would serve no useful purpose.

The Sixth Circuit Court of Appeals has quite clearly exceeded its role as an appellate court in the decision below and has invaded the province of the Tax Court. This decision is only one in what has been an alarming tendency not only in this but in other circuit courts to go beyond the appellate function and it is a situation which cries out for a firm restatement of the law by this Court. Because of the flagrant nature of the usurpation in the instant case it would appear to be an ideal medium for such pronouncement.

CONCLUSION.

This petition for a writ of certiorari should be granted because the decision below raises a conflict with other circuits in an important area of the law and because it represents a grievous deviation from the appellate function as previously defined by this Court.

Respectfully submitted,

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Counsel for Petitioners.

APPENDIX.

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

(Decided May 31, 1960.)

Before: MILLER, WEICK and O'SULLIVAN,* Circuit Judges.

MILLER, Circuit Judge. This litigation involves the respective tax liabilities of Gordon A. Stouffer and his divorced wife Ina Mae Marshman arising out of the divorce and the property settlement therein, which was granted to the wife on June 27, 1951. Ina Mae Stouffer thereafter married Homer H. Marshman. The cases were tried on a single record in the Tax Court and the three reviews of the two decisions of the Tax Court have been consolidated on this appeal.

Gordon A. Stouffer, hereinafter called Gordon, and Ina Mae Stouffer, hereinafter called Ina Mae, were married on February 22, 1930. This marriage was dissolved by an absolute divorce decree on May 24, 1934. Thereafter, Gordon asked Ina Mae to remarry him, which Ina Mae agreed to do provided Gordon would provide her with some financial security. On March 6, 1937, as part of this reconciliation, Gordon transferred to Ina Mae 2,000 shares of the Class B stock of The Stouffer Corporation, of which he was Vice-President and General Manager, which had an adjusted basis in his hands of $5.00 per share and which were then of the fair market value of $20.00 per share, or an aggregate value of $40,000.00. As part of the transaction Ina Mae executed to Gordon the following option:

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* On the day of the oral argument of the cases in this Court, Judge O'Sullivan was a District Judge sitting by designation. He was sworn in as Circuit Judge on April 4, 1960.

"In Consideration of One Dollar ($1.00), receipt of which is hereby acknowledged, I hereby give and grant to Gordon A. Stouffer the right and option to purchase from me at any time prior to the first day of January, 1967, two thousand (2000) shares of the Class B Common Stock of The Stouffer Corporation. at Twenty Dollars ($20.00) per share, payable in cash. Should any stock dividends be paid on said stock the price herein stipulated shall include such stock dividends. All cash dividends shall belong to the undersigned unless and until said option shall have been exercised."

Ina Mae also agreed to execute an irrevocable proxy in favor of Gordon to vote the stock. The next day, March 7, 1937, Gordon and Ina Mae were remarried.

During the years after 1937 and up until 1951 The Stouffer Company engaged in several transactions amounting to capital reorganizations involving stock dividends, stock splits and changes in description and denomination of exchanged stock. In these transactions the 2,000 Class B shares in the name of Ina Mae in 1937 became 20,000 shares of $2.50 par value common stock which Ina Mae held in 1951.

Thereafter, Gordon and Ina Mae again experienced marital difficulties and each retained counsel in anticipation of Ina Mae's instituting suit for divorce. During the latter part of 1950 and early part of 1951 counsel for Gordon and counsel for Ina Mae entered into negotiations for an agreement to be submitted to the court for approval in the event of such a divorce, which agreement was executed by the parties on May 10, 1951. On May 11, 1951, Ina Mae filed petition for absolute divorce in Court of Common Pleas of Cuyahoga County, Ohio, and on June 27, 1951, the said court entered a decree of divorce. The

decree incorporated the agreement of May 10, 1951. Gordon died June 6, 1956.

The following paragraph of the May 10, 1951, agreement gives rise to the issues involved in this litigation:

> "4. Gordon agrees that, upon the entry of such decree of divorce, any interest which he, or any other person, might, but for this agreement, have in any shares of stock of The Stouffer Corporation now registered in the name of Ina Mae, shall forthwith terminate, and Ina Mae shall continue to own, hold and vote such stock free of any claim by Gordon or anyone claiming by, through, or under him."

The fair market value of the 20,000 shares of the $2.50 par value common stock in The Stouffer Company held by Ina Mae on June 27, 1951, was $20.00 a share.

With respect to the income tax of Gordon for the year 1951, the Commissioner determined a deficiency in the amount of $90,077.75 on the ground that Gordon realized a taxable gain in the amount of $359,999.00 upon the surrender of the option in the divorce settlement and decree. This was based upon the ground that Gordon's option to repurchase for $40,000.00 the 20,000 shares of stock held by Ina Mae, which had a fair market value of $400,000.00, was worth the difference between those two amounts, namely, $360,000.00, less the consideration of $1.00 which Gordon paid at the time the option was executed. The deficiency was based upon the treatment of such taxable gain as a long-term capital gain. Later, however, the Commissioner took the position that the $359,999.00 gain constituted a gain attributable to the failure to exercise an option to buy property which, under Section 117 (g) (2) of the Internal Revenue Code of 1939 constituted a short-term capital gain rather than a long-term capital gain. Treating the gain as a short-term capital gain, the

Commissioner asserted an additional deficiency of $233,-418.48.

The Tax Court sustained the Commissioner's ruling that Gordon realized taxable gain in the amount of $359,-999.00, but held that this gain was a long-term capital gain and not, as contended by the Commissioner, a short-term capital gain. The Tax Court accordingly held that there was a deficiency in Gordon's income tax for the taxable year 1951 in the amount of $90,020.75, rather than in the larger amount. In appeal No. 13,945 the Commissioner seeks a review of the refusal of the Tax Court to sustain the additional deficiency of $233,418.48 which would result from a treatment of the gain as a short-term capital gain. In appeal No. 13,946 Gordon's estate seeks a review of the Tax Court's decision determining the deficiency in the amount of $90,020.75 or in any amount.

Appeal No. 13,944 involves the income tax liability of Ina Mae for the years 1952 and 1953 based upon the following additional facts. In 1952 Ina Mae sold 100 shares of the Stouffer stock, which was part of the 20,000 shares referred to above. In 1953 she sold 4,750 shares of this stock. The issue in this phase of the litigation is the correct basis of this stock in the hands of Ina Mae for the purpose of determining gain by her upon these sales. Based upon the Tax Court's ruling in the case of Gordon's estate that Gordon had realized a taxable gain of $359,-999.00 in surrendering the option, Ina Mae's basis in the 20,000 shares includes the amount of $359,999.00. The deficiencies held by the Tax Court to exist in Ina Mae's tax for the years 1952 and 1953 were based upon this ruling. The Commissioner takes the position that the decision of the Tax Court on this phase of the case is correct but, realizing that should this Court decide against the govern-

ment on the taxpayer's appeal in appeal No. 13,946, then Ina Mae's basis in the stock sold by her would in such event be accordingly decreased and the deficiencies would be larger. Accordingly, in order to protect the revenue in the event of a reversal in appeal No. 13,946, being the review sought by Stouffer's estate, the Commissioner has sought a review on this phase of the case by appeal No. 13,944.

The following sections of the Internal Revenue Code of 1939 are applicable. Section 22 (a) provides that gross income includes gains, profits, and income from sales or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property. Section 22 (f) provides, "In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in Section 111." Section 111 (a) provides, "The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in Section 113 (b) for determining gain, * * *." Section 111 (b) provides, "The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received."

The exact question presented has not heretofore been considered by this Court. A closely analogous question has had the consideration of the Board of Tax Appeals and the Courts of Appeals for the Second and Third Circuits.

In *L. W. Mesta*, 42 B. T. A. 933, the taxpayer, while a divorce action by his wife was pending against him, entered into a written agreement with his wife providing for a property settlement. Pursuant to the terms of the

agreement the taxpayer transferred to his wife certain securities having a value in excess of their cost to him and she surrendered all of her rights to support and maintenance and to share in his property at his death. The Board held that the rights received by the taxpayer under the agreement had no fair market value, and the taxpayer realized no taxable income as a result of the transaction. The Board pointed out that since the taxpayer received no money in exchange for the securities, the taxable gain under Section 111, Internal Revenue Code, resulting from the transaction would depend upon "the fair market value of the property (other than money) received"; that the measure of the value of the wife's right to maintenance and support was dependent upon so many uncertain factors that neither the taxpayer nor a revenue officer, even if equipped with all the aid which the actuarial art can apply, could do more than guess at it, *Humes v. United States*, 276 U. S. 487; and that the impossibility of evaluating the rights received by the husband constituted an insurmountable obstacle to the application of Section 22 in conjunction with Section 111 of the Internal Revenue Code. The Board also construed the transaction as basicly merely a property settlement between a man and his estranged wife—in other words, a division of property. It said "To hold that a man has realized taxable income by giving up a substantial portion of his property seems to us unreasonable and not justified either under general law or under the revenue act."

On review by the Third Circuit this ruling was reversed by a three to two vote. *Commissioner v. Mesta*, 123 F. (2) 986, C. A. 3rd, cert. denied, 316 U. S. 695, rehearing denied, 317 U. S. 704. The majority opinion, relying mainly upon *Helvering v. Horst*, 311 U. S. 112, held that

Mesta received an economic gain even though he may not have received payment in money or property from Mrs. Mesta; that the disposition of the securities was the taxable event which converted unrealized economic gain into realized economic gain; and that Congress intended a measurement of values under such circumstances, notwithstanding difficulties in determining those values. The Court recognized the difficulty and at the same time attempted to solve it by stating, "We think that we may make the practical assumption that a man who spends money or gives property of a fixed value for an unliquidated claim is getting his money's worth." The value of what the taxpayer received was accordingly held to be the same as the increased value of the securities which he transferred to his wife. The Court also stated, without discussion thereof, that the transaction could not be treated as a division of property. The two dissenting members of the Court concurred in the reasons given by the Board in reaching its decision.

In the meantime, while the review of the *Mesta* case was pending in Court of Appeals, the Board of Tax Appeals decided the case of *Walter S. Halliwell*, 44 B. T. A. 740. This involved the same question, except that the agreement entered into between the parties was approved by the divorce decree which ordered the husband to make the transfers agreed to. The Board considered this difference an immaterial one and approved and followed the Board's prior ruling in *L. W. Mesta, supra*, 42 B. T. A. 933.

On review by the Court of Appeals for the Second Circuit the decision in the *Halliwell* case was reversed in a per curiam opinion which cited and approved the ruling in *Commissioner v. Mesta, supra*, 123 F. (2) 986, C. A. 3rd. and held that the factual difference pointed out above was

a distinction without substance. *Commissioner v. Halliwell*, 131 F. (2) 642, C. A. 2nd.

The Tax Court in the present case followed the rulings of the Courts of Appeals in the *Mesta* and *Halliwell* cases. Three judges dissented for the reasons given by the Board of Tax Appeals in its opinion in *L. W. Mesta, supra*, 42 B. T. A. 933.

For the purposes of our discussion we will consider appeal No. 13,946 in which Gordon's estate, hereinafter referred to as the taxpayer, seeks a review of the deficiency assessment of $90,020.75. The taxpayer contends that the issue involved is an open one in this circuit and that the ruling of the Court of Appeals, by a closely divided court, in the *Mesta* case is not a sound one and should not be followed, and that in any event it is not applicable to the different factual situation existing in this case. We are of the opinion that these contentions have merit.

We agree with the reasoning of the Board of Tax Appeals in its opinion in the *Mesta* case that the wife's rights to maintenance and support and to share in the husband's estate in the event of his death are dependent upon so many uncertain factors and are of such a nature as to make it impossible to ascribe to it a "fair market value" as required by the statute. A review of these factors is given by the Board in 42 B. T. A. at p. 940, to which reference is made. We do not think that this problem is correctly solved by giving to those rights the value of the property which is given in exchange. Section 111(b) requires that the capital gain be measured by "the fair market value of the property * * * *received*" (Emphasis added) by the taxpayer, not by the fair market value of the property *transferred* by the taxpayer in exchange for the property received. To say that the fair market value of the property received is the same as the fair

market value of the property given up not only ignores realities, but is the use of a formula which is radically different from the well established and well recognized formula approved by the courts for determining fair market value. Under long established rulings fair market value is the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell. *Fitts' Estate v. Commissioner*, 237 F. (2) 729, 731, C. A. 8th; *In re Williams Estate*, 256 F. (2) 217, 218, C. A. 9th. A single transaction between a husband and wife made under the emotion, tension and practical necessities involved in a divorce proceeding does not comply with this rule. *United States v. Toronto, Hamilton & Buffalo Navigation Co.*, 338 U. S. 396, 402-407; *Heiner v. Crosby*, 24 F. (2) 191, 193, C. A. 3rd; *Champlin v. Commissioner*, 71 F. (2) 23, 29, C. A. 10th. See: *Sharp v. United States*, 191 U. S. 341, 348.

The evidence shows that because of the inclusion in the proposed settlement of some "emotional items," it looked at one time as though the negotiations were going to blow up and that there were occasions when the negotiations appeared about to break down. Under such conditions values are lost sight of, concessions are made, one does not expect or insist upon getting his money's worth for what he gives up. Unfortunately, it is often the case that what a husband transfers to his wife is in a so-called property settlement in a pending divorce action is not given merely in exchange for a release of alimony and dower rights, but also includes, without being so labeled, such additional amount as the husband may be willing to pay in order to have the marriage status terminated. A property settlement in a divorce proceeding is usually influenced and often dictated by numerous intangible, personal and practical considerations which play no part in

a transaction between a willing seller and a willing buyer in the open market. The value of what is given up is no criterion of the fair market value of the "property" received.

Recognizing the well settled rule governing the determination of fair market value and the existence of such intangible factors in a property settlement reached by the parties in a pending or contemplated action for absolute divorce, we are not able to agree with the final ruling in the *Mesta* case that the fair market value of the release by a wife of her alimony and dower rights against her husband and his estate is properly determined by ascertaining and giving to it the fair market value of the property which she receives from her husband. *United States v. Toronto, Hamilton & Buffalo Navigation Co., supra*, 338 U. S. 396, 402-407.

It is no answer to say that the economic gain realized under the ruling in *Helvering v. Horst, supra*, 311 U. S. 112, will escape taxation unless so evaluated. Nor do we consider it a correct answer to say that Congress intended a measurement of values notwithstanding difficulties in determining those values. *Helvering v. Horst* dealt with the *realization* of economic gain, not the *valuation* of such gain. The valuation and taxation of that gain under Section 111(b) was not involved. What Congress intended in the present case is shown by Section 111(b). By reason of the specific provisions of that section there is no *taxable* gain unless the amount of such economic gain is measured in a certain way. Congress did not intend or authorize that the measurement of taxable gain be made in any other way than that based on the fair market value of the property *received*. That requirement has not been complied with. If it has no fair market value, or if such fair market value has not been shown, it may be economic

gain but it is not taxable gain by reason of the express provisions of Section 111(b). *Champlin v. Commissioner, supra*, 71 F. (2) 23, 30, C. A. 10th.

In the present case the situation is further complicated by the question of the validity of the option. The evidence is uncontradicted that Ina Mae's attorney took the position that since the 2,000 shares of B stock no longer existed and the option covered stock dividends but not splits, it was only good at its best for 2,000 shares of the new stock for $40,000.00, that Gordon's attorneys devoted approximately sixty-three hours in a study of the problem without arriving at a conclusion, and that there were reasonable grounds for a bona fide dispute. Ina Mae's attorney testified that Gordon's attorney contended that the option was enforceable against the 20,000 shares and that the witness took the position that it was not enforceable. Both the attorney for Gordon and the attorney for Ina Mae testified that Ina Mae's attorney stated that a lawsuit would result if an attempt was made by Gordon to exercise the option for 20,000 shares. Gordon's attorney testified that Ina Mae stated to him when advised that an attempt would be made to exercise the option, "Well, you'll have to sue me to get it."; that Ina Mae's attorney stated, "Well, I don't care: I just don't care whethere the option is any good or not. As far as I am concerned, I am going to get this stock for Ina Mae and I am going to get all of it."; that as far as he could recall, there never was any further discussion about the legality of the option from that day on; that at one time he had proposed to release 17,000 shares on behalf of Gordon and keep 3,000 shares; that he later had a tentative agreement with Ina Mae's attorney to release 18,000 shares and keep 2,000 shares; and that finally when they had worked out all

the other things in the agreement he gave up on that and agreed to Ina Mae keeping all of the 20,000 shares. Ina Mae's attorney testified that it was apparent to him that this was a settlement of marital affairs, that ultimately it was going to be a division of property, and that it didn't seem to make a great deal of difference in which basket some of the assets were to be, so while it was discussed, it was never pursued to any great length; that there were occasions when the negotiation appeared about to break down; and in that event the matter of the validity of the option would certainly have been one of the questions at issue. It will be noticed that the property settlement agreement provides that any interest which Gordon "might" have in any shares of stock registered in the name of Ina Mae "shall forthwith terminate."

In view of this evidence we do not accept the Tax Court's finding that the great weight of the evidence established that there was no dispute between the parties about the validity of the option covering 20,000 shares in 1951, that it was admitted that Gordon was asserting that it covered the 20,000 shares, and the weight of the evidence was that Ina Mae agreed that it covered the 20,000 shares.

The Tax Court considered it unnecessary to pass on the validity of the option and did not do so, with which view we concur. The question involved is not whether at some time after the settlement agreement was entered into the option is held to be valid or invalid, but rather that at the time the settlement agreement was entered into there was a bona fide, unresolved dispute between the parties about its validity. It is common knowledge that such a dispute, similar to a cloud on title, has a material adverse effect upon the fair market value of any property being transferred. *Champlin v. Commissioner*, *supra*, 71 F. (2)

23, 30, C. A. 10th. With a bona fide dispute existing between the parties with respect to the validity of the option, with the reasonable possibility that it might be declared invalid, we are of the opinion that it can not be held in the absence of any supporting evidence that the value of the option was nevertheless the same as it would be if no question existed about its validity.

Even if we accept the ruling of the *Mesta* case that the fair market value of the release is the same as the fair market value of the option, it is impossible to tell from the evidence in this case what the fair market value of the option was. If the Commissioner's valuation of the option at its full face value of $359,999.00 is incorrect, it necessarily follows that the assessment was invalid and must be set aside. *Helvering v. Taylor*, 293 U. S. 507; *Durkee v. Commissioner*, 162 F. (2) 184, 187, C. A. 6th.

We agree with the view taken by the Board of Tax Appeals in the *Mesta* case, concurred in by the dissenting judges on the review of the Board's ruling in the Court of Appeals, and also approved by the three dissenting judges of the Tax Court in this case that the impossibility of evaluating "the fair market value of the property (other than money) received" by the husband from the wife in the property settlement entered into between them, constitutes an insurmountable obstacle to the application of Section 22(f) in conjunction with Section 111(a) and (b). Accordingly, we are of the opinion that the Commissioner's determination that Gordon Stouffer realized a tax gain in carrying out the divorce settlement was incorrect and the deficiency must be set aside.

This ruling in case No. 13,946 also controls the rulings to be made in appeals No. 13,944 and No. 13,945.

In the case involving the deficiency assessment against Estate of Gordon A. Stouffer, deceased, out of which arose appeals Nos. 13,945 and 13,946, the decision of the Tax Court is reversed and the case remanded to the Tax Court with instructions to enter judgment for said Estate and set aside the deficiency assessment in toto.

In the case involving the deficiency assessment against Homer H. and Ina Mae Marshman, out of which arose appeal No. 13,944, the decision of the Tax Court is reversed and the case remanded to the Tax Court for reconsideration and further proceedings in accordance with the ruling in appeals Nos. 13,945 and 13,946.

JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

(Filed May 31, 1960.)

On Petition to Review a decision of the Tax Court of the United States.

This cause came on to be heard on the transcript of record from the Tax Court of the United States and was argued by counsel.

On Consideration Whereof, It is now here ordered and adjudged by this court that the decision of the said Tax Court in this cause be and the same is hereby reversed and the case remanded to the Tax Court with instructions to enter judgment for said Estate and set aside the deficiency assessment in toto.

Approved for entry:

/s/ Shackelford Miller, Jr.,
United States Circuit Judge.

STATUTES AND REGULATIONS.

Internal Revenue Code of 1939:

SEC. 22 [As amended by Sec. 1 and 3, Public Salary Act of 1939, c. 59, 53 Stat. 574]. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * * .

* * * * *

(f) *Determination of Gain or Loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111.

* * * * *

(26 U. S. C. 1952 ed., Sec. 22.)

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

* * * * *

(26 U. S. C. 1952 ed., Sec. 111.)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * *

(26 U. S. C. 1952 ed., Sec. 112.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 939:

SEC. 29.111-1. *Computation of Gain or Loss.*—Except as otherwise provided, the Internal Revenue Code regards as income or as loss sustained, the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent. The amount realized from a sale or other disposition of property is the sum of any money received plus the fair market value of any property which is received. The fair market value of property is a question of fact, but only in rare and extraordinary cases will property be considered to have no fair market value. * * *

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JAMES R. BROWNING, Clerk

No. 366

In the Supreme Court of the United States

OCTOBER TERM, 1960

HOMER H. AND INA MAE MARSHMAN, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

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COMMISSIONER OF INTERNAL REVENUE

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MEMORANDUM FOR THE RESPONDENT

This case and *Estate of Gordon A. Stouffer, Deceased, Mark A. Loofbourrow, Executor* v. *Commissioner,* 30 T.C. 1244, were tried on a single record in the Tax Court.[1] Pursuant to stipulation of the parties, the cases were consolidated on appeal. The question presented in the instant case is the correct basis of certain Stouffer Company stock in the hands of Ina Mae Marshman. The answer to this question turns upon whether her former husband, Gordon A. Stouffer, realized taxable gain when, pursuant to a

[1] Gordon A. Stouffer and Ina Mae Marshman were husband and wife until their divorce in 1951. For protective reasons, the Government, contemporaneously with the filing of this memorandum, is filing a petition in the companion *Stouffer* case.

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divorce settlement, he surrendered a valuable option to purchase this stock in return for Ina Mae's release of her right to support and to share in his property at his death. If Gordon realized taxable gain, Ina Mae's basis would be increased by the amount of such gain. If he did not, the adjusted basis of the shares in her hands would be correspondingly less.

The Court of Appeals, reversing the Tax Court, held (Pet. 20–33) that, although Gordon may have realized economic gain, he did not realize taxable gain under the provisions of Section 111(b). Its reason for this conclusion was that it was not possible to measure the fair market value of the property received by him in exchange for surrendering the option.[2] In holding that Gordon realized no taxable gain, the Sixth Circuit expressed disagreement with *Commissioner* v. *Mesta*, 123 F. 2d 986 (C.A. 3d), certiorari denied, 316 U.S. 695, and *Commissioner* v. *Halliwell*, 131 F. 2d 642 (C.A. 2d), certiorari denied, 319 U.S. 741, which establish the rule (and apply it

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[2] Section 111 of the 1939 Code provides:

"SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

"(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

"(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received."

* * * * *

(26 U.S.C. 1952 ed., Sec. 111.)

to property settlements incident to divorce) that the value of property received should be measured, in the absence of other evidence, by the value of property given in exchange therefor.

The *Mesta-Halliwell* rule—which we think correct—rests on the practical assumption that a man who gives property of a fixed value for an unliquidated claim receives his money's worth. That rule or principle has been widely accepted and is of considerable administrative importance. Thus, it has been used to appraise stock received in exchange for assets (*Maine Steel, Inc.* v. *United States*, 174 F. Supp. 702, 714 (D. Me.); *Arco Manufacturing Corp.* v. *Commissioner*, 27 T.C. 547, 556); it has been the basis for determining whether a transfer in satisfaction of an unliquidated claim is for adequate and full consideration in money or money's worth or is properly a gift (*Commissioner* v. *Patino*, 186 F. 2d 962 (C.A. 4th); *Beveridge* v. *Commissioner*, 10 T.C. 915); it was applied by the Second Circuit in *International Freighting Corp.* v. *Commissioner*, 135 F. 2d 310, which held that the taxpayer had realized taxable gain when it used appreciated property to pay unliquidated bonus awards to employees.

Indeed, the Sixth Circuit itself has applied the *Mesta-Halliwell* principle in a case more recent than the instant one (see the opinion in *United States* v. *General Shoe Corp.*, reprinted in the Appendix, *infra*, pp. 7–16), though, in that case, the court regarded the situation as distinguishable because it did not involve a settlement incident to divorce. The question in *General Shoe* was whether the taxpayer

corporation realized taxable gain when it contributed appreciated property to an employees' retirement trust. In holding, as urged by the Government, that the corporation realized taxable gain to the extent that the property contributed had appreciated over its adjusted basis, the Sixth Circuit approved and followed *International Freighting Corp.* v. *Commissioner, supra,* which had reasoned that the consideration received must be deemed to be no less than the value of the property given. The court below found the situation presented in *General Shoe* distinguishable from that presented in the instant case, however, the ground of distinction being that *General Shoe* involved an arm's-length transaction uncomplicated by intangible, personal, and emotional factors.[3]

As matters stand, therefore, it appears that there is conflict between the Sixth Circuit and the Second and Third Circuits, but that the conflict is confined to transactions typified by husband-wife property settlements.

There is a further factor present in the instant case. The primary holding, as noted above, is that the husband's release of a valuable property right which had appreciated did not admit of a determination of capital gain because the *quid pro quo* received—the wife's release of unliquidated claims—is not susceptible of valuation. There is, however, a secondary holding. The court below also concluded (Pet. 32):

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[3] We invite attention to the fact that the Sixth Circuit's determination in *General Shoe* is not yet final. The taxpayer filed a petition for rehearing *en banc* and the Government, upon request of the court, has filed a response. The petition for rehearing is now *sub judice.*

> Even if we accept the ruling of the *Mesta* case that the fair market value of the release is the same as the fair market value of the option, it is impossible to tell from the evidence in this case what the fair market value of the option was.

We disagree with this holding because we do not think that the appellate court had an adequate basis for rejecting the Tax Court's finding that the parties had established the value of the option through arm's-length bargaining.[4] Nonetheless, we recognize that this issue is one confined to the peculiar facts of this case.

In sum, we believe that the court's primary holding represents a conflict with holdings in two other circuits. For this reason, we do not oppose grant of the writ. At the same time, we believe that the significance of this case is somewhat muted—*first*, because the *General Shoe* decision indicates that the area of

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[4] Ina Mae and Homer H. Marshman, Ina Mae's attorney at the time of the settlement, both testified that Mr. Loofbourrow, Gordon's attorney, had told them that the option was worth $360,000; that they both agreed that the option was of this value; and that they thought $360,000 was a fair settlement of her rights in an estate which would one day be worth a million and a half or two million dollars. (R. 44a–49a, 67a–69a.) The Tax Court heard these witnesses testify and believed them. (R. 105a.) Exhibits 17 and 18, prepared by Gordon's attorneys, clearly show that Gordon was negotiating on the basis that the option had a value of $360,000. Thus, at the time of the settlement agreement, all parties agreed to a value of $360,000. The Court of Appeals, in reversing the Tax Court's finding and in holding that there was a *bona fide* dispute as to the validity of the option at the time the settlement agreement was entered into, relied upon the testimony of a former attorney of Ina Mae who did not represent her at the time of the final settlement negotiations.

conflict is a circumscribed one; *secondly,* because the court below has also rested upon an alternative ground of decision. We recognize that in these circumstances this Court might well conclude that the instant case does not offer the most appropriate vehicle for resolving the issue as to which there is a conflict.

Respectfully submitted.

J. LEE RANKIN,
Solicitor General.

ABBOTT M. SELLERS,
Acting Assistant Attorney General.

I. HENRY KUTZ,
SHARON L. KING,
Attorneys.

OCTOBER 1960.

APPENDIX

United States Court of Appeals for the Sixth Circuit

No. 13914

UNITED STATES OF AMERICA, PLAINTIFF-APPELLANT

v.

GENERAL SHOE CORPORATION, DEFENDANT-APPELLEE

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF TENNESSEE

Decided September 2, 1960

Before MCALLISTER, *Chief Judge*; POPE, *Circuit Judge*; and THORNTON, *District Judge*.

THORNTON, *District Judge*. The facts in this tax case are not in dispute in any degree[5] important to disposition on appeal.

The issue here for determination is new to this Court except perhaps for an apparent similarity between it and that present in a case decided by this Court May 31, 1960.[1] We believe that there is a distinction of a fundamental nature between that case and this one. We shall advert to this distinction later on in this opinion.

For purposes of this appeal, a broad outline of the facts will suffice. In view of our treatment of the problem, we deem it unnecessary to go into the details which the District Court necessarily had to include in his findings of fact and conclusions of law. We affirm those findings. They constitute an excellent

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[1] *Commissioner of Internal Revenue* v. *Marshman et al.*, * * * F. 2d. * * *.

presentation of the factual background which revolves around the plan of appellee, hereafter referred to as the taxpayer, to create a pension or retirement trust for the benefit of its employees. The taxpayer did, in fact, execute such a plan which consists of a trust to which the taxpayer contributed assets. We are here concerned with assets contributed during the fiscal years 1951 and 1952, and taken as deductions by the taxpayer on its corporate tax returns for such years. These assets consisted of two parcels of real estate located at or near Atlanta, Georgia, appraised at $160,000 and $250,000, respectively, at about the time of the contributions. Another parcel in Atlanta was contributed, and its value was determined to be $37,500 (based on the sale of it by the trust). The last such contribution with which we are concerned is real estate located at Huntsville, Alabama, and appraised at $600,000. The appellant, hereafter referred to as the Government, put in issue by amended answer (1) these market values, (2) whether they were actually contributed to the trust during the taxable years for which deductions were taken, and (3) whether the trust was a qualified trust "exempt from taxation under Section 165(a), Internal Revenue Code of 1939, so that contributions are deductible under Section 23(p)." The District Court found, and we think correctly, for the taxpayer on all three questions. The Government accepts such findings for purposes of this appeal so we will not concern ourselves with them. We observe, however, that these findings have been most carefully prepared.

In its conclusions of law, the District Court concludes as follows, and we quote the six paragraphs comprising the conclusions:

CONCLUSIONS OF LAW

1. The Court has jurisdiction of the parties and subject matter herein by virtue of Section 7422 of the Internal Revenue Code of 1954, and Sections 1340 and 1346, Title 28, United States Code.

2. Plaintiff's Employees Retirement Trust complied with the provisions of Section 165(a) of the Internal Revenue Code of 1939, with the result that contributions to the trust by plaintiff in the years ending October 31, 1951 and October 31, 1952, respectively, were properly deductible under Section 23(p). The law does not require that the employer have a legal obligation to make contributions to a trust in order for the trust to be exempt. *Lincoln Electric Co. Employees' Profit Sharing Trust, et al.* v. *Commissioner of Internal Revenue* (C.A. 6, 1951), 190 F. 2d 326. Having made no misrepresentation to the Treasury Department, it was an abuse of discretion to rule in 1958 that the plan and trust did not conform to Section 165(a). *H. S. D. Co.* v. *Kavanagh* (C.A. 6, 1951), 191 F. 2d 831. The ruling letter of February 11, 1958, holding that the plan does not meet the requirements of Section 165(a) of the 1939 Internal Revenue Code of Section 401(a) of the 1954 Code and that the trust is not qualified under said sections and is not exempt from taxation was based on an erroneous view of the law and is of no effect.

3. The plaintiff was entitled to the deductions on its income tax returns for the years ending October 31, 1951 and October 31, 1952, respectively, representing the fair market values of the properties contributed to the trust, to wit: $160,000 for the Lawrenceville, Georgia property and $250,000 for the Caroline Street, Atlanta, property, in 1951, and $37,500 for the Yonge Street, Atlanta, property, and $600,000 for the Huntsville, Alabama property in 1952.

4. Section 111(a), Internal Revenue Code of 1939 provides that the "gain from the sale or other disposition of property" [which is included in the definition of "gross income" contained in Section 22(a)] "shall be the excess of the amount realized therefrom over the adjusted basis. * * *" Section 111(b) provides:

"Amount Realized. The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received."

In contributing these properties to the trust, the plaintiff did not receive any money, and did not receive the equivalent of money since no debt or legal obligation was discharged; it did not receive any "property" having "fair market value" within the meaning of said section; and hence there was no "amount realized" from the contributions to the trust. That being the case, there was no taxable gain.

5. The case of *International Freighting Corporation* v. *Commissioner of Internal Revenue*, 2d Cir., 135 F. 2d 310, relied on by the defendant, should not in the opinion of the Court be followed or applied in the present case. A careful analysis of the opinion in that case compels the conclusion that the Court lost sight of the statute requiring as a prerequisite to liability for a capital gains tax receipt by the taxpayer of either "money" or "property." The decision was based upon the court's theory of consideration, which theory itself is subject to question, rather than upon the receipt of "property" as required by the basic statute. It is not contended, of course, that the taxpayer received "money," nor is the Court able to find from the facts of the case that it received "property" within the meaning of the statute, whatever may be said about consideration. While the decision of the Court of Appeals of another circuit is persuasive, it should not be

followed where it is clear that the decision itself constitutes a departure from the controlling statute.

6. Plaintiff is entitled to judgment for the amount of taxes paid by it as the result of the erroneous assessment of capital gains taxes on the contributions of real estate to its Employees Retirement Trust, plus the interest paid by plaintiff on said amount, and also for interest as allowed by law, and for allowable costs.

We find ourselves in complete agreement with the District Judge in his conclusions of law numbered 1, 2 and 3. We think the law is clearly to the effect that a pension or retirement plan such as was here established complied with the Code so as to enable the taxpayer to deduct [under Section 23(p)] contributions made by the taxpayer to the trust. The fact that the taxpayer was not obligated in this respect does not preclude it from taking the deduction, nor the trust income from being exempt from taxation. The District Court made proper conclusions of law in this respect. This Court, in *Lincoln Electric Co.* v. *Commissioner*, 6 Cir., 190 F. 2d 326, determined the *exemption* issue, and in *Lincoln Electric Co.* v. *Commissioner*, 6 Cir., 162 F. 2d 379, determined the *deduction* one in opinions written by Judge Simons. In an opinion written by Judge Miller of this Court in 1950,[2] the same reasoning is applied as in the earlier *Lincoln Electric* case cited, and the same conclusion is reached re deductibility from gross income as an ordinary and necessary business expense.

It is with the conclusions of law numbered 4–6 that we find ourselves in disagreement with the court below, and as to which we must reverse.

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[2] *Commissioner* v. *Surface Combustion Corp.*, 6 Cir., 181 F. 2d 444.

A few details of factual background as to the capital gains feature of the case, as distinct from the trust-contribution-deduction feature, are here in order. When the taxpayer made the real estate contributions to the trust, it took deductions on its corporate income taxes in the amounts of the appraised values of these properties. These deductions were allowed, but a capital gains tax was assessed, measured by the difference between the assessed valuation (or fair market value) and the basis. The taxpayer paid these capital gains taxes and filed timely claims for refund. Said claims were disallowed and this action is the result. The District Court agreed with the taxpayer that it had not realized a *taxable* capital gain. We believe that this was an erroneous view of the law. We think that the rationale of *International Freighting Corporation* v. *Commissioner of Internal Revenue*, 2d Cir., 135 F. 2d 310 is persuasive. We recognize, of course, that the decision there is not controlling, and we do not here hold that the court below was bound by it as such. We can hardly state the rationale of that decision better than Judge Frank did in his short succinct opinion in *Freighting*. When the taxpayer *here* made the contributions to the trust it was entitled to take, and did take deductions for such contributions as "ordinary and necessary" expenses. When the taxpayer evaluated the contributions on the basis of the then current market value and used those figures for its deductions, it then realized capital gain to the extent that such values exceeded its basis. There is no gainsaying this logic. The tax statutes do not operate in theory—they are practical. The disposition of the real estate by the taxpayer resulted in an "amount realized" within the meaning of Section 111(b)—

> Amount Realized. The amount realized from the sale or other disposition of property shall

> be the sum of any money received plus the fair market value of the property (other than money) received.

The taxpayer realized exactly the same gain here by transferring the real estate as it would have had it sold the real estate for the fair market (or appraised) value and contributed the funds to the trust. Would the taxpayer say that if it had sold the real estate that there would have been no taxable capital gain in this situation? Can a taxpayer circumvent the capital gains tax by such a simple device? In *Helvering* v. *Horst*, 311 U.S. 112, 115 the court says that "Where the taxpayer does not receive payment of income in money or property realization may occur when the last step is taken by which he obtains the fruition of the economic gain which has already accrued to him." In *Lucas* v. *Ox Fibre Brush Co.*, 281 U.S. 115, 119 Mr. Chief Justice Hughes, directing his attention to the issue of the reasonableness of extra compensation for work done, referred to payments made "as a matter of internal policy having appropriate regard to the advantage of recognition of skill and fidelity as a stimulus to continued effort." Surely the same considerations are present in relation to a plan whose purpose is as stated in the present case:

ARTICLE I: PURPOSE

> The purpose of this Plan is to provide for the accumulation of a fund to pay annuities to regular employees of the Corporation upon retirement because of age or disability after a period of faithful service with the Corporation, and to supplement the benefits provided under the Federal Social Security Act.

The theory of economic gain comes into play. To argue, as the taxpayer does here, that there can be no gain because nothing is realized, is unrealistic. Lit-

erally the taxpayer is correct in its contention that it did not receive a tangible benefit * * * however, we do not conceive that in this day and age we are restricted to tangibles in tax matters where there is actual recognizable benefit, albeit intangible, the taxation of which is implicit in the statutory scheme, and where such benefit is clearly capable of being evaluated on an objective basis. It is at this point in our discussion of this case that we deem it pertinent to distinguish the *Marshman* case decided by this Court May 31, 1960. The differences are fundamental and the similarities superficial. The instant case and the *Marshman* case have a common meeting ground retroactively, so to speak. In no respect do we believe there exists any real conflict. The retroactive meeting ground is *Freighting*[3] for the reason that it presents a factual picture closely analogous to the one here. It cites in support of its legal conclusion re taxable capital gain the *Mesta*[4] and the *Halliwell*[5] cases, and also *Kenan* v. *Commissioner*, 2 Cir., 114 F. 2d 217. In *Marshman*, *supra*, this Court disagrees with *Mesta* and *Halliwell*, those cases having dealt with property settlements in divorce actions. The *Kenan* case is not subject to the same infirmity, however, and is valid support for the taxable gain rationale in *Freighting*, which has direct application to the instant case. We reiterate what Judge Miller of this Court said in *Marshman* that if the property *received* "has no fair market value, or if such market value has not been shown, it may be economic gain but it is not taxable gain by reason of the express provision of Section 111(b)." *Marshman*, as well as *Mesta* and *Halliwell*, involved a property settlement in a

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[3] Supra, 135 F. 2d 310.

[4] *Commissioner* v. *Mesta*, 3 Cir., 123 F. 2d 986.

[5] *Commissioner* v. *Halliwell*, 2 Cir., 114 F. 2d 217.

divorce action. Quoting from Judge Miller's opinion again:

> A property settlement in a divorce proceeding is usually influenced and often dictated by numerous intangible, personal and practical considerations which play no part in a transaction between a willing seller and a willing buyer in the open market. The value of what is given up is no criterion of the fair market value of the "property" received.

The truth of this observation is, of course, readily apparent. How different are the facts here. The value of what was given up here bears a direct relationship to the fair value of the "property" received. The "property" received is an economic gain to the taxpayer of exactly the market or assessed valuation which the taxpayer used as a deduction on its income tax returns. Again, in the *Marshman* case, this Court cites *Helvering* v. *Horst, supra* and points out that the Supreme Court there was dealing with "the *realization* of economic gain, not the *valuation* of such gain." The difficulty inherent in the application of the economic gain theory in *Mesta*, in *Halliwell*, and in *Marshman* is directly related to the *valuation* of the gain rather than its *realization*. That difficulty is readily overcome in the matter herein. This is an arm's length situation. Emotional factors are not involved. The measurement of the intangible benefits is easily reduced to dollars and cents. We do not here have the *Marshman* "insurmountable obstacle to the application of Section 22(f) in conjunction with Section 111(a) and (b)." We experience no difficulty in accepting as the fair market value of the property received by the taypayer the appraised valuation which the taxpayer took as a deduction on its income tax returns. This is consistent with the statement of Judge Miller in *Marshman* that "Under long estab-

lished rulings fair market value is the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell. * * * A single transaction between a husband and wife made under the emotion, tension and practical necessities involved in a divorce proceeding does not comply with this rule." We have quoted the foregoing in order to point up the width of the gulf between the considerations entering into *valuation* of transfers made in cases like *Mesta, Halliwell* and *Marshman* compared to the valuation of those effected in *Freighting* and in the instant case.

In accordance with the foregoing reasoning, we are of the opinion that the determination of the District Court that the taxpayer did not realize a taxable gain when it made the transfers and took the deductions for their fair market value was an erroneous one. The decision is therefore reversed and the judgment of the court below vacated.